BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2002-2-E - ORDER NO. 2002-460

JUNE 14, 2002

IN RE: South Carolina Electric & Gas Company – Annual Review of Base Rates for Fuel Costs	)	ORDER DENYING PETITION FOR RECONSIDERATION

This matter comes before the Public Service Commission of South Carolina (the Commission) on the Petition for Reconsideration of Order No. 2002-347, filed by the Consumer Advocate for the State of South Carolina (the Consumer Advocate). Because of the reasoning stated below, the Petition is denied and dismissed.

The Consumer Advocate states in his Petition that, in order to apply the evidence received in this case to the applicable law, the Commission must adopt the 63% proxy factor to those purchases of power that do not contain a fuel cost breakdown. We reject this assertion, and any prior assertions that a 60% proxy might be appropriate.

The Commission has addressed a difficult issue in this case arising out of the Company's right to recover fuel costs related to purchased power and the necessity for the utilization of a proxy for reasonably determining these costs. For the past five years, the Company and Commission have relied upon an avoided cost proxy for this purpose. The necessity for a proxy arises out of the fact that in today's energy markets, marketers generally have no information about the fuel cost incurred in generating power offered for purchase. Indeed, if they have such information, they are likely to consider it proprietary and confidential because of the competitive nature of the marketplace. This is true whether the marketer is a utility which has generated such

power or is a utility or other marketer which has acquired power from another source. This quasi-competitive, yet quasi-regulated, marketplace results from initiatives of the Federal Energy Regulatory Commission (FERC) to open the wholesale power market to greater competition. Among other things, FERC created the Negotiated Market Sales Tariff, under which wholesale bulk power sales are almost exclusively transacted. One result is that utility-affiliated power marketers are separated from other bulk power functions and required to conduct themselves and their businesses comparably to other power marketers with no utility affiliation. Thus, information about costs becomes private, competitive information and the marketplace focus is on prices rather than cost analyses in potential transactions.

All of the parties to this matter acknowledge that the foregoing circumstances necessitate the use of a proxy. The question is, "What proxy"? During the past five years, the Consumer Advocate has acquiesced in the Commission's use of an avoided cost proxy in SCE&G's recovery of the cost of purchased power. However, in a recent fuel proceeding involving Carolina Power & Light Company (CP&L) (Docket No. 2002-1-E), the Consumer Advocate and CP&L introduced a stipulation requesting Commission approval of a fuel factor based on a 60% fuel allowance proxy applied to purchased power where the specific fuel cost was not known. This proxy was based on a "Marketer Stipulation" approved in North Carolina for utilities in that State and agreed to by CP&L.

On this issue in the present case, staff witness Watts testified as follows:

Q. Do you believe use of this proxy [i.e. the 60% proxy] for determining the allowable fuel portion of purchased power expenses is the most appropriate methodology?

A. I believe there is no question that the use of some type of proxy is not only reasonable and appropriate, but also consistent with the application of the

South Carolina fuel clause statute. I believe the most realistic approach, consistent with the controlling guidelines should be applied in determining the best methodology for use in this situation. I do not believe that the 60% proxy fuel factor would be the most appropriate to use in this case. Just because it may be appropriate in another jurisdiction does not mean that it is also appropriate here. Since utilities have different operations, generation mix, and power requirements, it is reasonable to conclude that it is not necessarily appropriate to use the same proxy for everyone, but rather a utility specific factor may be more precise and representative of actual experience. The current use of this generic 60% fuel proxy in North Carolina was based on a range of fuel cost to total energy cost for off-system sales for the utility companies in that State; included off-system sales for NC Power; and was based on data from some period prior to August of 2001. This generic factor is also variable, and prior to the current 60% level, the factor had been set at 70%. These facts and issues show some of the weaknesses and lack of applicability of this specific factor and methodology in this case.

Q. Please explain how the use of a proxy is consistent with the South Carolina Fuel Clause Statute.

A. In addition to the language defining "fuel cost" there are other portions that provide further guidance and insight when applying the Act in specific instances. One area addresses the offsetting of cost of fuel recovered through sales of power to neighboring utilities against fuel costs to be recovered. See Section 58-27-865(E) (Supp. 2001). Another area spells out the rebuttable presumption of prudence in operation by a utility of its nuclear generation facilities with the attaining of a certain level of production during the review period. See Section 58-27-865-(F) (Supp. 2001). Also, as I have indicated in prior fuel cases, in evaluating a utility's fuel costs under the Act, it is important to keep in mind language in section (F) pertaining to costs that can be disallowed. This section reads in part "...giving due regard to reliability of service, economical generation mix, generating experience of comparable facilities, and minimization of the total cost of providing service". I believe with this and the other language embodied in the Act, it is clear that the aim is to encourage the affected utility to operate its production system, including the purchase power option, in the most effective and efficient manner. This is in full concert with provision of electric service at the most reasonable and prudent rate, through minimization of the total cost of providing service. Consistent with this approach is the method Staff has been applying through the use of a monthly, utility specific avoidable fuel cost proxy for purchase power, where no specific fuel component was identified. This is also similar to the way the utility determines the most

> economical operation of its system by comparing the cost of its next available unit to the cost of purchasing the power required from another provider. A significant component of these comparisons is the cost of fuel to generate the power from the utility's own plant. I believe the objective should be to establish a proxy that most appropriately satisfies these operating criteria. As a matter of fact, this method of using the utility's avoided cost as a proxy for the fuel portion of the purchase power cost has been used for many years in determining the rate that a utility pays for power under certain contracts. These contracts are those between the utilities and Qualifying Facilities under the Public Utility Regulatory Policies Act of 1978. This Commission has approved rates based on this methodology, which is required under PURPA.
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> Therefore, I believe continuation of the use of the prior proxy methodology which Staff has been using is the most appropriate and prudent, and is also consistent with the South Carolina fuel statute.

While supporting the recommendation of staff witness Watts, staff witness Cherry, for Commission information, attempted to replicate, with South Carolina information, the North Carolina calculations which resulted in a 60% fuel proxy. She reviewed 24 sales from CP&L or Duke Energy to SCE&G and determined that the cost of fuel for generation represented 63% of the price of power for those purchases.

S.C. Code Ann. § 58-27-865(B) requires each electric utility to submit its estimation of fuel cost to be recovered for the 12 months period of operation succeeding a fuel proceeding before the Commission. Subsection (G) of the statute requires the Commission to allow electric utilities to recover "all their prudently incurred fuel costs. . . in a manner that tends to assure public confidence and minimize abrupt changes in charges to customers." Finally, subsection (A) of the statute defines "fuel costs" as "the cost of fuel, fuel costs related to purchased power, and the cost of SO2 to emission allowances. . ." All of this is done against the statutory backdrop mandating that utilities have an obligation to minimize the total cost of providing service. Subsection (F).

In interpreting the foregoing provisions, the Commission is mindful of the cardinal rule of statutory construction, which is to ascertain and effectuate the intent of the Legislature. *Charleston County. Sch. Dist. v. State Budget and Control Bd.*, 313 S.C. 1, 437 S.C. 2d 6 (1993). In construing a statute, the Commission must not only consider the language being construed, but the meaning of the words in conjunction with the purpose of the whole statute and the policy of the law. *Williams v. Williams*, 333 S.C. 386, 517 S.E. 2d 887 (1993).

In this case, the Commission believes that it cannot reasonably adopt the 60% fuel factor advocated by the Consumer Advocate or the 63% fuel factor analysis presented as information by staff witness Cherry. The Commission is disinclined to approve either of these specific fuel factors for the following reasons. As to 60%: To the extent that the percentage stipulated in the CP&L matter is derived from any reported data, the data are not subject to anyone's tests or verification and, in fact, may be predicated on an entirely different experience from that in this jurisdiction. Moreover, it may reflect practices that CP&L employs with regard to retail regulation in North Carolina. There is no evidence of record that correlates this experience to South Carolina and, indeed, the evidence indicates that the percentages may change from time to time for reasons unspecified. As to 63%: The Commission is also disinclined to adopt a 63% fuel factor, as discussed by Ms. Cherry, for several reasons. The sample on which this calculation was made is extremely small. It is based on a limited number of sales of power from CP&L and Duke Energy to SCE&G. It does not account for sales from other sources to SCE&G. Moreover, the calculation is apparently not what was done in North Carolina.

The Commission, therefore, concludes that the adoption of a 60% or 63% fuel factor would be arbitrary and capricious.

For the reasons stated in his testimony, the Commission adopted the analysis of staff witness Watts, as articulated above, and approved the use and results of the utility-specific avoidable fuel cost proxy. Based also on the testimony of witness Watts and Company witness Klein, the Commission found that the consuming public is best served by using this proxy. The methods of recording avoided costs as described by Company witness Klein and the auditable nature of those records permit the Company and staff auditors to follow, not only summarized cost data, but the summarized avoided costs data, back to original source documents.

Whereas the Consumer Advocate refers to the adopted proxy as a "100% avoided cost proxy factor," we would note, as the Consumer Advocate does in another part of his Petition, that the "100%" applies only up to SCE&G's avoided cost. In other words, any part of a purchase price that exceeds SCE&G's avoided cost is disallowed.

While not a perfect solution, the Commission believes the use of an avoidable cost proxy is consistent with the overall regulatory objective articulated in the statutes discussed above and protects the ratepayers of this State by insuring that the utility minimizes the total cost of providing service in this State in a way that is verifiable by Commission audit. The Consumer Advocate's Petition is therefore denied and dismissed.

This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Chairman

ATTEST:

Executive Director

(SEAL)